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No. 04-805

IN THE

Supreme Court of the United States

TEXACO, INC.,

Petitioner,

v.

FOUAD N. DAGHER, *et al.*,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

REPLY BRIEF FOR PETITIONER

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

REPLY IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI 1

I. THE CONFLICT IN DECISIONS OVER WHETHER A JOINT VENTURE'S OPERATION OF ITS OWN BUSINESS MAY BE TREATED AS CONCERTED ACTION IS SQUARELY PRESENTED 3

II. THE CONFLICT IN THE CIRCUITS OVER WHETHER THE RULE OF REASON OR *PER SE* TREATMENT IS PROPER IN CIRCUMSTANCES WHERE SECTION 1 APPLIES AT ALL IS ALSO SQUARELY PRESENTED 7

CONCLUSION 10

TABLE OF AUTHORITIES

Page

Cases

Augusta News Co. v. Hudson News Co.,
269 F.3d 41 (1st Cir. 2001) 9

Broadcast Music, Inc. v. CBS, Inc.,
441 U.S. 1 (1979) 9

Citizen Publ'g Co. v. United States,
394 U.S. 131 (1969) 9

Copperweld Corp. v. Independence Tube Corp.,
467 U.S. 752 (1984) 6, 10

NCAA v. Bd. of Regents,
468 U.S. 85 (1984) 9

Nat'l Bancard Corp. v. Visa U.S.A.,
779 F.2d 592 (11th Cir. 1986) 8

Polk Bros., Inc. v. Forest City Enters.,
776 F.2d 185 (7th Cir. 1985) 9

Statutes

15 U.S.C. § 1 1-8

Other Authorities

Federal Trade Commission & Department of Justice Antitrust Division, *Antitrust Guidelines for Collaborations Among Competitors*, 4 Trade Reg. Rep. (CCH) ¶ 13,161 (2000) 2

U.S. General Accounting Office, *Motor Fuels: California Gasoline Price Behavior* (April 2000) 5

REPLY IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

The issue in this case is whether a joint venture's setting of the price of its own product can be condemned as *per se* illegal under Section 1 of the Sherman Act. The Ninth Circuit held that it could, based on two critical legal rulings: (1) that a joint venture's operation of its own business may be treated as concerted action of the venture's owners based on the owners' involvement in the venture's decisions; and (2) that a joint venture's prices are *per se* illegal unless the particular price selected—as opposed to the setting of any price at all—is necessary to achieving the venture's anticipated efficiencies. As Texaco's and Shell's petitions demonstrate, these rulings conflict with decisions of this Court and other circuits, are contrary to basic antitrust principles, and create a dangerous precedent that will deter companies from entering the very kinds of legitimate, efficiency-enhancing ventures the antitrust laws were intended to protect.

Respondents' response is to assume the very question to be decided. They assert that no issue is presented as to when a joint venture's operation should be considered single-firm conduct rather than concerted action because the Ninth Circuit resolved that issue against petitioners. But it is precisely that ruling that creates the issue. Contrary to respondents' assertion (Opp. at 1), the question is not the validity of any "factual findings." The question is the governing legal standard, and whether the facts the Ninth Circuit relied upon (and which respondents rehearse again) can properly be the basis for applying Section 1 in this context. On that question, respondents are essentially silent. Although reciting the Ninth Circuit's ruling, they do not attempt to reconcile it with the governing antitrust standards or with the decisions of other courts (and the views of leading commentators) that Section 1 should not apply in these circumstances. The importance of this issue and the need for this Court's review are thus unrefuted.

Respondents take the same approach on the question whether, assuming Section 1 applies, *per se* treatment is proper. They simply recite the Ninth Circuit's ruling that it is, unless the particular price selected is "necessary." But the validity of the Ninth Circuit's "necessity" standard is the very question to be decided. And respondents again do nothing to square the Ninth Circuit's decision with those of other courts addressing this issue and holding that *per se* treatment is not proper. None of the cases respondents cite demand the kind of "necessity" showing the Ninth Circuit required here.

Respondents' effort to dodge the issues only highlights their importance. Respondents do not deny the need for clear, workable standards in this area. Nor do they deny the valuable role joint ventures play in the nation's economy. Certiorari is needed to resolve the conflict in the circuits and bring needed certainty to the application of the antitrust laws to joint venture conduct.[1]

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[1] Although Texaco believes that the petitions and the opposition by themselves demonstrate the need for this Court's review, the Court may wish to invite the Acting Solicitor General to express the views of the United States. As their Antitrust Guidelines for Competitor Collaborations illustrate, the Federal Trade Commission and the Department of Justice have a strong and direct interest in the proper interpretation of the antitrust laws as they apply to joint ventures. Moreover, the FTC engaged in a comprehensive review of Equilon's formation and concluded that, subject to certain divestitures, Equilon could lawfully refine and market gasoline under the Shell and Texaco brands in the United States. Indeed, the Guidelines use the facts of Equilon's formation as an example of a joint venture that should be treated as a merger under the antitrust laws, directly contrary to respondents' assertion that Equilon should be treated as an ongoing conspiracy between its two owners. The Ninth Circuit's ruling that Equilon and its owners can be found *per se* liable for conducting the very business that the FTC and various states concluded they could lawfully form is starkly at odds with those conclusions.

I. THE CONFLICT IN DECISIONS OVER WHETHER A JOINT VENTURE'S OPERATION OF ITS OWN BUSINESS MAY BE TREATED AS CONCERTED ACTION IS SQUARELY PRESENTED.

Respondents rely on a litany of facts that they claim support the Ninth Circuit's conclusion that Equilon's pricing decisions should be viewed as concerted action. The question presented in this case is whether respondents (and the Ninth Circuit majority) are correct that Section 1's application in this context turns on these kinds of facts; or whether instead, as other courts and commentators have recognized, full economic integration in a joint venture—*i.e.*, "collective assumption of risk and resource pooling in the joint ventures," which "ended competition between Shell and Texaco throughout the nation in the areas of downstream refining and marketing of gasoline" (Pet. App. 5a)—means that the pricing of the joint venture's products is, as a matter of law, the action of a single firm rather than of competitors. This question is squarely presented in this case. Indeed, it is precisely the issue that divided the majority and the dissent below. *Compare* Pet. App. 6a & n.4, 19a n.11 (majority op.) (finding concerted action by attributing the pricing decision to Shell and Texaco based on their discussions in forming and overseeing the venture), *with* Pet. App. 31a (Fernandez, J., dissenting) (concluding that the pricing decision was that of Equilon itself as "a separate entity" that "owns all of the production, transportation, research, storage, sales and distribution facilities for engaging in the gasoline business").

Respondents first point to facts showing that Shell and Texaco continued to exist as separate entities. Opp. at 4-6. They note that the companies did not combine their "international refining and marketing operations," that they continued to be "world-wide competitors," and that they accordingly retained ownership of their respective brand names. *Id.* Rather than eliminating the question presented, however, these facts give rise to it. They establish only that

Equilon's formation was not a complete merger between Shell and Texaco. Had there been a complete merger, presumably even the Ninth Circuit would have ruled that the merged entity's operation would not be subject to Section 1 scrutiny. It is precisely because the companies did not completely merge that the Section 1 issue is presented.

Relying on these same facts, respondents seek to create the impression that Equilon was not a legitimate joint venture but just a front for two competitors to end price competition between their two brands. But the Ninth Circuit did not base its decision on any such premise, recognizing instead that Equilon was an economically integrated entity with "collective assumption of risk and resource pooling." Pet. App. 3a, 5a. Nor is respondents' premise accurate. As respondents concede (Opp. at 4), Equilon combined the entire Shell and Texaco refining and marketing (or downstream) operations in the western United States (while another joint venture, Motiva, which is not at issue here, did the same in the eastern United States). Shell and Texaco did not retain ownership of any of the assets contributed to Equilon. Neither of them made or sold any of the gasoline; Equilon did. Neither of them had the right to use their brands for gasoline during the existence of Equilon in the markets where it operated.[2] That is the reason the FTC concluded the joint venture should be treated as the equivalent of a merger in the relevant market. In short, respondents' suggestion that the Ninth Circuit's decision applies only to Equilon and does not threaten a wide range of

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[2] Thus, it is irrelevant that Shell and Texaco retained ownership of their brand names. Opp. at 5-6. They had granted Equilon the exclusive right to use the names in the United States gasoline market and they retained no separate interests in the profits obtained from the gasoline sales attributable to any particular brand. Instead, profits of the venture were allocated based on a fixed percentage corresponding to the assets each company contributed at formation.

joint ventures is unsupportable, and the question whether Section 1 applies to the operation of a *bona fide*, economically integrated joint venture is directly presented.

For this reason, respondents' attempt to analogize this case to a hypothetical joint selling arrangement between Ford and General Motors (Opp. at 15-16) is meritless. Shell and Texaco were not jointly selling gasoline that they separately produced and owned. They had completely merged their entire domestic gasoline refining and marketing operations into a new business entity, which itself produced and owned the gasoline.

Respondents observe that Shell and Texaco agreed to "end competition" between them. Opp. at 5. Again, however, that agreement is precisely what frames the issue for review. The agreement that ended competition was the agreement to form Equilon in the first place. There is no dispute that *that* agreement triggered scrutiny under Section 1. But respondents do not challenge that agreement, which the FTC and the state attorneys general reviewed and concluded did not violate the antitrust laws.[3] The question presented here is therefore whether, with Shell and Texaco having validly agreed to combine their operations and end competition, the

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[3] That review included examination of the share of the relevant market that Equilon would possess and led to the FTC requiring divestitures in certain areas to address any market power issues. Except for those divestitures, the regulators concluded Equilon's share of the market did not violate the antitrust laws.

Like the Ninth Circuit, respondents note (Opp. at 7-8) that gasoline prices increased in late 1998 and early 1999 by more than 50% even though crude oil prices were stable or dropping. They imply that Equilon's pricing decision somehow caused the price increase. What the Ninth Circuit and respondents omit is that the spike in the market price of gasoline was temporary and coincided with supply problems that quite naturally put upward pressure on prices. *See* U.S. General Accounting Office, *Motor Fuels: California Gasoline Price Behavior* 12-13 (April 2000).

ongoing operation of the combined entity should be treated as a continuing conspiracy of the two companies.

Respondents next point to various facts purportedly showing that Shell and Texaco played a continuing role in Equilon's operation, including the Members Committee with representatives from each company, the Brand Management Protocols, and the Strategic Marketing Initiative through which respondents assert Shell and Texaco influenced Equilon's pricing behavior. Opp. at 5-7. Respondents' reliance on these facts likewise confirms the need for review. The owners of any business must oversee or "control" the business in some manner, whether directly or by delegation to the business' employees. It is therefore vital that companies participating in or contemplating joint venture activities have clear guidance on whether such control or oversight is relevant to the applicability of Section 1 and potential antitrust liability. Where (as in this case) the owners of the venture no longer compete in the relevant market and their oversight or control of the joint venture pertains to the venture's operation in that market, involvement by the owners in the venture's operation should not trigger Section 1, because the owners have a "complete unity of interest" with respect to that venture. *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 771 (1984). As demonstrated in the petition (Pet. at 10-13) and as respondents do not dispute, other courts and commentators agree. But the Ninth Circuit ruled to the contrary. Certiorari is needed to resolve the intolerable uncertainty created by this conflict.

Similarly, respondents' assertion (Opp. at 7) that Equilon implemented a particular pricing strategy heightens, rather than diminishes, the need for review. Every business entity, whether public corporation, private partnership or legitimate joint venture, must create a pricing strategy; no business can operate without one. And the particular pricing strategy adopted by a business—whether selling its two brands at the same price, or at different prices—is immaterial to the

antitrust analysis. Under Section 1, a business entity is permitted unilaterally to set its own prices, free from any requirement to justify the prices to an antitrust court. Certiorari should be granted to establish that this principle applies in the joint venture context.

Respondents do not attempt, at least expressly, to defend the Ninth Circuit's decision on the other ground relied on by that court, namely that the pricing strategy may have been agreed to by the joint venture members while it was being formed rather than after formation. As the petition explains (Pet. at 21), no competitive consequence attaches to whether the venture partners agreed to a particular operating decision in forming the venture or after it was formed (so long as that decision is *implemented* only if and when the joint venture entity is actually formed).

In short, no antitrust principle exists by which the Ninth Circuit's decision can be limited to the timing of Equilon's adoption of its pricing strategy, the particular strategy adopted, or Equilon's management structure. If there is any logic to the decision below, it applies to and puts at risk a wide range of actual and potential joint ventures operating in the Ninth Circuit's broad geographic reach. Respondents' assertion (Opp. at 21) that owners of a joint venture can escape liability by proving that the joint venture entity's particular pricing strategies are necessary to further the legitimate aims of the joint venture is little solace. As a single entity, a joint venture entity is not required to justify its unilateral pricing, much less demonstrate that the particular strategy adopted is necessary.

II. THE CONFLICT IN THE CIRCUITS OVER WHETHER THE RULE OF REASON OR *PER SE* TREATMENT IS PROPER IN CIRCUMSTANCES WHERE SECTION 1 APPLIES AT ALL IS ALSO SQUARELY PRESENTED.

Respondents' argument on the subsidiary question whether rule of reason or *per se* treatment should apply

confirms that the Ninth Circuit adopted a standard of "necessity" that directly conflicts with the decisions of other courts of appeals. Respondents do not dispute that the Ninth Circuit ruled that it is not enough that Equilon needed to set *some* price for the gasoline it sold and that defendants were thus required instead to prove the necessity of the *particular* pricing strategy Equilon adopted. Although respondents try to dismiss this as a "factual finding" (Opp. at 1), it is in fact a legal ruling as to the proper test for determining when the *per se* rule applies.[4] And, as we demonstrated in the petition (Pet. at 13-14), that legal ruling conflicts with the decisions of the First and Eleventh Circuits addressing this issue in the specific context of pricing decisions and the decisions of other circuits addressing it as to analogous kinds of restraints.

In denying a circuit split, respondents ignore four of the seven conflicting decisions of the courts of appeals cited in the petition. *See* Pet. at 13-15; Opp. at 17-18. They badly misconstrue the three conflicting decisions that they do discuss. Their effort to distinguish the Eleventh Circuit's decision in *National Bancard Corp. v. Visa U.S.A.*, 779 F.2d 592 (11th Cir. 1986), misses the main points of that case—that the rule of reason, not the *per se* rule, applies to decisions by a joint venture on pricing its products if the circumstances warrant application of Section 1 at all, without any need to prove that the particular price was necessary to the enterprise. As the court noted, the issue was whether imposing an "interchange reimbursement" fee was necessary to the existence of the product offered by the joint venture, not whether the particular fee set was necessary. *Id.* at 602.

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[4] It is true, of course, that the Ninth Circuit further concluded that an issue of fact exists as to whether the particular prices Equilon charged satisfied the Ninth Circuit's legal standard. But the propriety of that ruling is not at issue here. The issue is whether the Ninth Circuit was correct in requiring such a showing in the first place.

Contrary to respondents' suggestion (Opp. at 18), neither *Augusta News Co. v. Hudson News Co.*, 269 F.3d 41 (1st Cir. 2001), nor *Polk Bros., Inc. v. Forest City Enters.*, 776 F.2d 185 (7th Cir. 1985), turned on whether the joint venture was offering a new product. So long as the formation of the joint venture itself is lawful, it is irrelevant whether the venture's output is considered new or different.

Respondents' argument (Opp. at 13-14) that the decision below "follows directly" from cases applying the *per se* rule to "naked restraints on price competition" proceeds from the mistaken premise that a joint venture's pricing decisions are "naked restraints." A decision by a business entity, whether made directly by its owners or delegated by them to the entity's employees, on how to price or otherwise operate its business has never been considered a naked restraint.

Nothing in *Broadcast Music, Inc. v. CBS, Inc.*, 441 U.S. 1 (1979), nor *NCAA v. Bd. of Regents*, 468 U.S. 85 (1984), supports respondents' position. *See* Pet. at 23-24. Those decisions stand for the proposition that even where the participants in a venture continue to compete in the same market, the issue is only whether setting a price—some price—is necessary, not whether the particular price is necessary. In both decisions, this Court rejected the contention that the *per se* rule applies.

The fact that Shell and Texaco "retained their corporate identities" (Opp. at 16) and competed outside the United States and in exploration and production markets does not make this case like the partial joint venture in *Citizen Publishing Co. v. United States*, 394 U.S. 131 (1969). Unlike the newspapers in that case, Shell and Texaco contributed all of their refining and marketing assets in the western United States to Equilon. Unlike the newspapers, Shell and Texaco participated in that market only through Equilon and did not compete as separate companies in that market.

Respondents' argument (Opp. at 12) that "the fixing of prices for the Shell and Texaco brands had absolutely no relationship with any efficiencies or cost-savings" is both mistaken and immaterial. Mistaken, because no joint venture can sell its products without setting their prices; it was incumbent upon Equilon to "fix" prices for the two brands at some level. Immaterial, because under *Copperweld*, 467 U.S. at 768, a single economic actor can select whatever price it chooses for its product without the need to demonstrate any relationship to any business goal. To the extent respondents are referring to setting the same price for the two brands, the antitrust laws do not require an entity (whether joint venture, public corporation or private partnership) to justify its particular unilaterally-adopted pricing strategy.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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